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THE DIRECTOR OF CENTRAL INTELLIGENCE

WASHINGTON, D.C. 20505

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National Intelligence Council 3 February 1982

MEMORANDUM FOR: Director of Central Intelligence
Deputy Director of Central Intelligence

FROM : [redacted] 25X1
Acting National Intelligence Officer for USSR-EE

SUBJECT : Tomorrow's NSC Meeting [redacted] 25X1

Poland

1. Tomorrow's NSC meeting will deal with the extra-territoriality issue involved in sanctions against the USSR as these affect the Yamal pipeline (see Tab A). The meeting will probably also touch upon broader questions of West European reactions and Soviet options in case of a firm U.S. position. (See Tab H)

2. At the SIG on Friday it became apparent that the Office of the Vice President and all agencies except State held that the December 30, 1981 sanctions should apply not only to exports from the U.S. but also to equipment made by foreign subsidiaries of U.S. firms and by licensees. The issue of making an exception for controlled GE components already shipped or for the fulfillment of existing contracts or letters of intent has arisen particularly in the case of the UK where the estimated losses and layoffs are held to be especially painful. The arguments pro and con are summarized on pp. 1-2 of the NSC paper. [redacted] The main argument for application of the sanctions to subsidiaries and licensees is that without this the sanctions would be ineffective in slowing or stopping development of the pipeline. The basic argument against is that the political cost in terms of strained relations with our allies would be too great. (See Tab E for contracts signed.)

3. The legal issues at stake are discussed in an attachment to the NSC paper, Tab A. The thrust of the opinion here is that the Administration's authority to take some of the actions contemplated would be tenuous, that some steps might be successfully countered in the U.S. courts, and that West European governments if they so wished could take legal action that would block the U.S. or escalate matters into a major confrontation within the Atlantic Alliance.

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4. There is also the danger that tough U.S. actions could affect negatively a developing West European mood in favor of firmer steps against the USSR over Poland. If the West Europeans came to believe that the U.S. was using the Polish crisis in order to achieve a goal it had not been able to reach earlier by diplomacy, namely to block the pipeline, they would probably become even more resistant on this issue and less forthcoming on other possible sanctions. This danger underlines the need to handle the issue with finesse and sensitivity.

5. If we were to force the issue with an expanded embargo, our analysts believe that the West Europeans could come up with their own replacement for the embargoed GE equipment and for the computerized control system--if the Soviets provided sufficient incentives and Western governments went along. This might delay completion of the pipeline, but by no more than a year or so. (See Tabs **B** and E.)

6. Alternatively, the Soviets might rearrange their priorities and shift some of their substantial domestic compressor capacity to Yamal or an alternative line at the expense of delaying domestic gas availability. Because Yamal will apparently take only 12% of planned added compressor capacity in the 1981-85 time period (3050 MW out of 25,400), this appears feasible although with a loss of efficiency and perhaps some delay. (See Tab **B**.) However, the Soviets might be able to start gas exports from Urengoy in Siberia before the completion of Yamal by adding a segment to a new "domestic" line being built from Urengoy to Novopskov. This line might be extended to, and through, Czechoslovakia by 1984-85. (See Tab **E**.)

7. Although it appears possible for the Soviets to complete Yamal by themselves with some delay or even to export gas early via a non-Yamal route, the denial of U.S. technology would nonetheless be costly to the Soviets. By slipping, say, two of the 56" pipelines, Moscow would delay the availability to the domestic economy of the equivalent of about 500,000 barrels of oil, about 2% of total energy consumption. Since domestic gas can be and probably is largely intended to replace oil, this gas delay could deprive the Soviets of around $5 billion in oil hard-currency earnings.

8. In short, although we cannot be confident that our sanctions would delay Yamal or a substitute for it, there is a good chance that if the West Europeans honored an expanded U.S. embargo and did not supply substitute equipment and controls, this would do one of the following: (a) delay the export of gas capable of earning about $5 billion a year; or (b) delay the availability of gas to the Soviet economy, thus forcing the Soviets either to make do with less energy, or forego the export of that oil which would otherwise be replaced by domestic gas.

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9. You are well aware of the importance of Western credits for the Yamal pipeline, and of the line's eventual capacity to earn hard currency. This factor becomes even more significant when viewed against the USSR's current hard-currency bind. To improve their liquidity somewhat the Soviets have sold off about 50 tons of gold in the first two weeks of this year--about one-fourth of all the gold they sold in 1981 and about one half of what they sold in 1980. They have also stepped up their short-term borrowing. These palliatives do not eliminate the longer-term problem: how to pay for an import bill which has gone up from $2.2 billion in 1970 to $31.3 billion in 1981 and which is likely to increase further. So far the Soviets have relied primarily on their oil sales and credits to increase their hard-currency purchasing capability. The projected decline in Soviet oil production and probable limits to future borrowing underline the Soviet need for the Yamal pipeline--the only significant new source of hard currency in the offing. (See Tab J.)

10. These short-run and long-term hard-currency needs combined with the high opportunity costs of an export pipeline built by the Soviets themselves strongly suggest that the Soviets will do what they can to keep the Yamal deal as currently arranged--low-interest Western credits paying for Western materiel to create a Soviet hard-currency earning capability of about $5 billion a year. Unfortunately, there is no way in which the U.S. can singlehandedly deal the pipeline a fatal blow. In my opinion, the real issue for the NSC is how to create a climate in which West European governments, private companies and banks come to see the entire deal as an increasingly dubious proposition--an outlook that could be strongly reinforced by new repressive actions or violence in Poland. Doubts about the wisdom of the deal have already surfaced in Europe. The Italians, for instance, have been talking about a pause for reconsideration. So far none of these doubts have been followed by decisions against participation. Yet, U.S. arguments have not fallen on completely deaf ears. The problem for the U.S. now is how to give these budding European second thoughts a dynamic of their own. I believe that all U.S. pipeline policy decisions should be seen from that perspective.

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DDI/06I

Comments on Scope of Sanctions Involving Oil and Gas Equipment Exports to the Soviet Union

We agree with the general assessments presented in the paper. The sanctions already imposed by the United States on the sale of equipment to the Soviet Union is likely to delay compressor deliveries by one to two years beyond the planned 1985 completion date of the pipeline. Because we expect other factors such as severe environmental conditions to delay construction by one to two years, late delivery of the compressors would not represent a bottleneck.

Most European governments would react strongly to attempts to expand the scope of the sanctions. The French government, however, has stated that it will not undercut US sanctions and Alsthom-Atlantique has indicated it does not plan to make the investment necessary to expand its capability to supply additional compressor parts. Several other European firms have already backdated some contracts with Japanese firms in an attempt to avoid the sanctions.

Effective application of the sanctions to subsidiaries and licensees would prevent the Soviets from obtaining the GE compressors and effectively stop development of the project as now envisioned. The only viable option would be to redesign the project to use Rolls Royce turbine technology. If the Soviets moved quickly and sales of Rolls Royce equipment could not be prevented by US sanctions or cooperation from the UK government, the project probably could still be completed by 1987/88.

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Comments on 2 February 1982 NSC Memo --

Extraterritorial Application of the December 30 Decision

We concur with the paper's premise that some immediate action is necessary to show our allies that we intend to continue escalating our reponse to Polish repression. Allied governments continue to share our view that the Polish situation is deteriorating. West European public interest is ebbing, however, and governments will pressure Poland only if they believe our resolve is unshaken. [redacted] 25X1

We disagree, however, that there "is no compelling reason to hold back on tough measures." The Allies view Western economic and political ties with the Soviet Union as exercising an important moderating influence on Soviet behavior, and the threat of breaking those ties as a key reason that the Soviets have resisted invading Poland. If those ties are broken now, they would argue, the Soviets would feel that they had little to lose internationally by an invasion. In other words, the Allies feel that the West risks losing its leverage by using it prematurely. [redacted] 25X1

Because additional contracts are being signed and the West Europeans almost certainly would not apply sanctions retroactively, sanctions will have progressively less effect with the passage of time. The desire to get things nailed down helps explain French (and Soviet) interest in signing the pipeline agreement so soon after imposition of martial law; it may also

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account for the recent <u>two-year</u> West German pipe supply contract (such contracts were to be negotiated annually). There is obviously a large dose of cynicism in the West European approach, but the West Europeans perceive similar cynicism in the US sanctions imposed so far. On the other hand, the public outcry in France over the pipeline arrangement suggests that the domestic political cost of completing contracts may be greater than the West European governments had expected. 25X1

Our biggest problem with the paper is our belief that it understates the obstacles to an effective policy, even one implemented immediately. The understatement is particularly noticeable in the executive summary. There are three interrelated questions that need to be answered:

- o What would it take to get the Allies to sign on with sanctions?
- o Should the US impose a grain embargo?
- o How does one make the operational connection -- as distinct from the rhetorical one -- between Poland and the pipeline?

We would argue that the body of the paper makes a far better stab at answering these questions than the executive summary; that those answers are fairly daunting; and that they should be made more explicit in the executive summary. 25X1

The executive summary merely states that "there is no hope of getting tough Allied action unless we are willing to take tough new steps ourselves." DDI/EURA's consistent position has been that the only US step that would be considered tough enough

-- the only thing we can do that would involve costs comparable to those we are asking the West Europeans to pay -- is a grain embargo. The body of the paper makes this point on page 6, and we believe the executive summary should do the same. But the language on page 6 makes a further worthwhile point: that perhaps not even a grain embargo would be enough; we might also have to offer to subsidize the Allies. This point too needs to be in the executive summary. [redacted] 25X1

Furthermore, the executive summary ignores the pipeline question after noting that stopping the pipeline is one of our objectives. The summary would serve its readers better if it explicitly addressed the question whether "tough Allied action" was likely to include either a halt in pipeline negotiations or a cancellation of agreements already concluded. We believe the pipeline would be one of the last things the West Europeans would give up, mainly because for any number of reasons they resist the notion of connecting it to the situation in Poland. The body of the paper hints at one reason for this resistance on page 7, when it notes that even if things went improbably well in Poland, the United States would still oppose the pipeline. The West Europeans suspect that this is the case; if pressed they would probably argue that until the United States made an ironclade linkage between the two issues they would be under no complusion to do so. [redacted] 25X1

Concerning the specific questions of extraterritorality and retroactive application of GE-related sanctions, SOVA's 29 January memo appears to be the best word on the subject. West [redacted] 25X1

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The principal conclusions of the SOVA memo are (1) even with an effective embargo of GE-related equipment the Soviets -- with West European help -- should be able to construct the pipeline approximately on schedule; and (2) if the project fell behind schedule, delays intrinsic in a Soviet project of this scope would probably be a bigger factor than delays related to supplies of compressors and compressor parts. [redacted] 25X1

Option five -- which considers actions against Cuba, Libya, or Afghanistan -- would entail a serous disruption of the Alliance. It would indeed shift allied popular and government concern from Soviet to US agression. It would seriously reduce our ability to forge an allied consensus on policy toward Poland, and on policy toward the other areas where we perceive an important Soviet threat. [redacted] 25X1